

NO REPORT REQUIRED  
Release under E.O. 12958

Date 9/22/92

Surname [REDACTED]

AUG 03 1992

Dear Applicant:

We have considered your application for recognition of exemption from federal income tax under section 501(a) of the Internal Revenue Code as an organization described in section 501(c)(3). Based on the information submitted, we have concluded that you do not qualify for exemption under that section.

The information submitted indicates that you were incorporated under the laws of [REDACTED] on [REDACTED] to "alert educators and those who need it to the existence of a special reading program for persons with learning disabilities, and to make it available to as many such persons as possible." The reading program is the [REDACTED] developed by [REDACTED], two of your directors. In addition, [REDACTED] is your president and [REDACTED] is your secretary and Reading System Developer. [REDACTED] hold the copyright to the [REDACTED].

[REDACTED] have been teaching people to read using [REDACTED] for over twenty years, first through [REDACTED], then through [REDACTED], and subsequently through [REDACTED]. [REDACTED] is a for-profit corporation controlled by [REDACTED]. The reading program made \$[REDACTED] in [REDACTED]. The program is taught at [REDACTED] and is sold through books and audio cassettes. [REDACTED] has more than [REDACTED] employees. [REDACTED] has estimated that when the program is fully patented, it will generate \$[REDACTED] million in royalties and sales. [REDACTED] has issued [REDACTED] shares of common stock and [REDACTED] shares of preferred stock to raise [REDACTED] dollars to be used to set up a satellite center, video conferencing system and an in-house broadcasting network. [REDACTED] has the exclusive rights to all of the software and hardware of the [REDACTED], including the [REDACTED] reading books and the [REDACTED] audio and video programs.

You propose to use the [REDACTED] to teach illiterates to read. You plan on broadcasting it via a satellite system and a video conferencing system to juvenile correctional centers and public schools. You propose to teach reading in

juvenile detention centers, early release correctional institutions, and adult education centers.

According to the budgets you submitted, substantially all of your expenditures will be paid to [REDACTED] or to [REDACTED], which is controlled by [REDACTED]. Out of total budgeted expenditures of less than \$ [REDACTED], you propose to pay [REDACTED] an annual salary of \$ [REDACTED] and [REDACTED] an annual salary of \$ [REDACTED]. You have indicated that [REDACTED] will work 8 hours a day, five days a week for you. [REDACTED]'s duties consist of supervising and preparing materials for early release prison programs and juvenile correction centers, teaching classes for early release prison programs and juvenile correction centers through video conferencing, evaluating all reading instruction results, and adapting the [REDACTED] to teach Hispanics to read English. [REDACTED]'s duties include developing educational programs other than reading for early release prison programs and juvenile correction centers, writing the story of how he overcame being clinically dead which left him paralyzed, blind and voiceless, manufacturing all software and hardware of the [REDACTED], and obtaining international patent for the [REDACTED]. You propose to pay [REDACTED] \$ [REDACTED] a year for lease of corporate headquarters at [REDACTED]. (You subsequently stated that the rent would be \$ [REDACTED] per month.) The son and daughter of [REDACTED], but you have indicated that they will move once you begin broadcasting. [REDACTED] currently operates out of this building. The budget also indicates expenditures of \$ [REDACTED] per year for the video conferencing system. Although you originally proposed to lease this from an unrelated third party, in subsequent submissions you stated that [REDACTED] will acquire the video broadcasting system, along with the satellite center and in-house broadcasting network, all of which you will lease from [REDACTED]. In addition, although it is not included in your budgets, you have stated you will be paying [REDACTED] a fee for the use of the [REDACTED] and the [REDACTED] audio and video programs.

Section 501(c)(3) of the Code provides, in part, for the exemption from federal income tax for corporations organized and operated exclusively for charitable, scientific or educational purposes, provided no part of the corporation's net earnings inures to the benefit of any private shareholder or individual.

Section 1.501(c)(3)-1(a)(1) of the Income Tax Regulations provides that in order to be exempt as an organization described in section 501(c)(3) of the Code, an organization must be both

organized and operated exclusively for one or more of the purposes specified in such section. If an organization fails to meet either the organizational test or the operational test, it is not exempt.

Section 1.501(c)(3)-1(d)(1)(ii) of the regulations provides that an organization is not organized or operated exclusively for one or more exempt purposes unless it serves a public rather than a private interest. The organization must establish that it is not organized or operated for the benefit of private interests, such as designated individuals, the creator or his family, shareholders of the organization, or persons controlled, directly or indirectly, by such private interests.

In Texas Trade School v. Commissioner, 30 T.C. 642 (1958) aff'd 272 F.2d 168 (5th Cir. 1959), the court held that part of the net earnings of the organization in question inured to the benefit of private individuals when the organization paid excessive rent for property owned by officers and directors of the organization.

In Birmingham Business College, Inc. v. Commissioner, 276 F.2d 476 (5th Cir. 1960), the court held that an organization did not qualify under the predecessor section of section 501(c)(3) of the Code because it had been operated as a business producing substantial revenues for its operators and that net earnings were distributed to its shareholders for their own personal benefit in the form of compensation.

In est of Hawaii v. Commissioner, 71 T.C. 1067 (1979) aff'd 647 F.2d 170 (1981), the court held that the activities of the organization in question served the commercial purposes of for-profit corporations and, therefore, the organization was not operated exclusively for exempt purposes within the meaning of section 501(c)(3) of the Code. The organization had entered into contracts with the for-profit corporations through which the for-profit corporations substantially controlled the organization's activities and which required the payment of a substantial amount of the organization's gross revenue to the for-profit organizations.

You are organized and operated primarily for the benefit of private interests rather than public interests. You propose to pay excessive salaries to [REDACTED], in part for work that benefits [REDACTED] or the [REDACTED] personally. For example, part of [REDACTED]'s duties is to adapt [REDACTED] to teach Hispanics to read English while [REDACTED]'s duties include manufacturing software and hardware for [REDACTED] and obtaining international patents for [REDACTED]

[REDACTED]

[REDACTED]. Since the [REDACTED] hold the copyright for the system and [REDACTED] holds exclusive rights to the software and hardware of the system, [REDACTED]'s activities are for their own benefit and the benefit of [REDACTED]. Furthermore, you propose to pay substantial rent to [REDACTED] for the building which it is currently using for its own operations and for equipment as well as substantial amounts for the use of the [REDACTED]. Therefore, substantially all of your expenditures are paid for the benefit of two of your officers and directors, [REDACTED], either directly through compensation or indirectly through rent and other payments to [REDACTED], a for-profit corporation controlled by [REDACTED]. Thus, as in Texas Trade School and Birmingham Business School, Inc., you propose to pay excessive amounts in compensation and rent directly and indirectly to persons who control your operations. While the for-profit corporation to which you make substantial payments does not control your operations as in est of Hawaii, both you and the for-profit corporation are controlled by the same individuals, [REDACTED]. Consequently, you are not organized and operated exclusively for exempt purposes within the meaning of section 501(c)(3) of the Code.

Accordingly, you do not qualify for exemption from federal income tax under section 501(a) of the Code as an organization described in section 501(c)(3). Contributions to you are not deductible under section 170 of the Code. You must file federal income tax returns.

You have the right to protest this ruling if you believe it is incorrect. To protest, you should submit a statement of your views, with a full explanation of your reasoning. This statement, signed by one of your officers, must be submitted within 30 days from the date of this letter. You also have a right to a conference in this office after your statement is submitted. You must request the conference, if you want one, when you file your protest statement. If you are to be represented by someone who is not one of your officers, that person will need to file a proper power of attorney and otherwise qualify under our Conference and Practice Requirements.

If you do not protest this ruling in a timely manner, it will be considered by the Internal Revenue Service as a failure to exhaust available administrative remedies. Section 7428(b)(2) of the Code provides, in part, that a declaratory judgement or decree under this section shall not be issued in any proceeding unless the Tax Court, the Claims Court, or the District Court of the United States for the District of Columbia determines that

[REDACTED]

the organization involved has exhausted administrative remedies available to it within the Internal Revenue Service.

If we do not hear from you within 30 days, this ruling will become final and copies will be forwarded to your Key District Director in Atlanta, Georgia. Thereafter, any questions about your federal income tax status should be addressed to that office. The appropriate State Officials will be notified of this action in accordance with section 6104(c) of the Code.

When sending additional letters to us with respect to this case, you will expedite their receipt by using the following address:

Attn: [REDACTED], Room 6127  
Internal Revenue Service  
1111 Constitution Avenue, N.W.  
Washington, D.C. 20224

If you have any questions, please contact the person whose name and telephone number are shown in the heading of this letter.

Sincerely,

[REDACTED]  
[REDACTED]  
Chief, Exempt Organizations  
Rulings Branch 4

cc: DD, Atlanta  
Attn: EO Group

cc: State Officials of [REDACTED]  
[REDACTED]

	Initiator	Reviewer	Reviewer	Reviewer	Reviewer	Reviewer	Reviewer	Reviewer
Code	[REDACTED]	[REDACTED]						
Surname	[REDACTED]	[REDACTED]						
Date	7/20/92	7/31/92						